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No. 94-644

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

HERCULES INCORPORATED,
Petitioner,

v.

UTAH STATE TAX COMMISSION
AUDITING DIVISION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of the State of Utah

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REPLY BRIEF OF PETITIONER

KEITH E. TAYLOR
MAXWELL A. MILLER
PARSONS BEHLE & LATIMER
201 South Main Street
Suite 1800
Salt Lake City, UT 84111
(801) 532-1234

REX E. LEE *
CARTER G. PHILLIPS
NATHAN C. SHEERS
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 736-8000

Counsel for Petitioner

* Counsel of Record

November 16, 1994

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In the petition for a writ of certiorari, petitioner Hercules Incorporated demonstrated that (1) the decision of the Utah Supreme Court below permitted Utah to excise a double tax on the income generated by the interstate sale of Trident missile motors in direct conflict with this Court's Commerce Clause precedents, and (2) *only* this Court can resolve this controversy generated by the taxation of the same income by more than one state.

Respondent disingenuously seeks to disguise the constitutional infirmity inextricably imbedded in the foundation of the Utah Supreme Court's decision in this case. Indeed,

respondent does not even mention, much less discuss or analyze, petitioner's principal case from this Court addressing the problem of unfairly apportioned tax assessments, *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123 (1931). Instead, respondent attempts to bury the Commerce Clause issue in this case in a morass of alleged "factual squabble[s]" (Opp. 10) in hopes that the Court will decline to review the decision of the court below. But the decision below—permitting Utah to apply its income tax to the entire value of the interstate sales at issue here—presents a pure question of law both suitable for review and warranting review by this Court.

1. After several years of litigation over the disputed tax in this case, respondent for the first time asserts that "the record contains no evidence whatsoever as to the income tax implications in this case" (Opp. 14) and attempts to turn a blind eye to its own pre-hearing stipulation, reproduced at Pet. App. 34a-36a. Contrary to respondent's assertion, the record clearly establishes that double taxation of petitioner's income resulted from Utah's decision to tax 100% of the income generated by the Trident missile motor sales.

First, petitioner does not have a "profound misunderstanding" (Opp. 6 n.7) of how income is allocated under UDIPTA for state income taxation, nor did it "mischaracterize" (*id.* at 6) what is subject to taxation. As petitioner previously explained (Pet. 4), income, and not sales, are taxed under UDIPTA. This is clear even from the citations to the petition contained in respondent's brief. See Opp. 6 n.7 ("Hercules repeatedly contends that it has been taxed on '100% *of the income* from those sales' ") (quoting Pet. 4-5) (emphasis added). Respondent has made the only "fatal[] mischaracteriz[ation]" (*id.* at 6) in this case. Petitioner has focused on the sales factor of the income tax allocation formula because it is the income generated by the rocket motor sales that has been subjected to double taxation. *Cf.* Brief of Utah State Tax Comm'n in the Utah S. Ct. at 4 ("The issues in this case pertain only to the sales factor of the formula").

Respondent cannot deny that it *is* taxing *income* when it inputs figures into the in-state numerator of UDIPTA's three-factor formula. Additions to the sales numerator have a direct and proportional effect on income apportionment. Respondent is attempting to play a shell game with the three-factor formula when it suggests that the income generated by the rocket motor sales was not "direct[ly]" taxed. Opp. 6. If respondent's characterization is accepted, apportionment formulas could never be reviewed for conformity with the Commerce Clause. This Court's decision in *Shell Oil Co.* v. *Iowa Department of Revenue,* 488 U.S. 19, 31 (1988), cited by respondent (Opp. 6), did hold that "the inclusion of income in the *preapportioned tax base* of a state apportionment formula does not amount to extraterritorial taxation." *Shell Oil,* 488 U.S. at 30-31 (emphasis added). However, the preapportioned tax base involves the *denominators* in the three-factor formula. *Id.* at 22 nn. 3-4. As this Court recognized in *Shell Oil,* income from sales included in the in-state *numerator* is directly taxed. *Id.* at 31 (sales at issue "not taxed directly by any State because they are not included in the numerator of the sales ratio").

Second, notwithstanding respondent's current denial (Opp. 16), Utah stipulated and agreed that it was "uncontroverted" (Pet. App. 34a) that California included the sales of all rocket motors shipped to California in the in-state numerator of its three-factor formula. *Id.* at 35a. Therefore, both California and Utah directly taxed all the income generated by these rocket motor sales. Not only is double taxation clear on the record before this Court, it is clear that 100% of the income generated by the rocket motor sales was taxed in each jurisdiction.

Likewise, it was stipulated and agreed that petitioner paid Washington tax on all motors shipped to Washington on the basis that Washington considered delivery of the motors to have occurred there. *Id.* at 35a. Washington has adopted the Multistate Compact's UDIPTA. See Wash. Rev. Code § 82.56.010. Whatever may be said about the character of Washington's Business and Occupa-

tion Tax,* and whether UDIPTA's three-factor formula was applied by Washington to determine petitioner's tax burden, it is clear from the record that Washington taxed the rocket motor sales, and that it only taxed those sales that it apportioned to the state. Irrespective of their labels, both state taxes assessed were taxes on the income generated by the rocket motor sales. Furthermore, the issue of double taxation is squarely raised by this case if *either* California or Washington had already taxed the income generated by the rocket motor sales subsequently taxed by Utah.

2. Not only is the record concerning double taxation clear, the interstate nature of the transactions taxed by Utah is readily apparent. Respondent claims that "Hercules has confused the concepts of interstate sales and interstate commerce." Opp. 9. Faced with the undeniable interstate nature of the missile transaction and the federal interests at stake in this dispute (see Pet. 7), respondent attempts to distinguish between interstate sales and intrastate sales that "involve interstate commerce" (see Opp. 9). This argument is another transparent ruse by Utah to evade its obligations under the Commerce Clause. The simple fact of the matter is that the Utah Supreme Court determined that the Commerce Clause was not violated because the sales were "transactions occurring solely within this state." Pet. App. 9a. The Utah Supreme Court made no distinction between "sales" and "commerce." Moreover, no such distinction is plausible if the allocation of income between the various states is to be governed by constitutional standards rather than artificial labels concocted by states attempting to maximize revenues. Despite the passing of legal title in Utah, petitioner performed substantial activity at the seaport sites in Califor-

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* In *Deseret Pharmaceutical Co.* v. *State Tax Commission*, 579 P.2d 1322 (Utah 1978), the Utah Supreme Court upheld respondent's use of UDIPTA's income tax allocation provisions to apportion a taxpayer's income as represented by Washington's Business and Occupation tax.

nia and Washington where it interfaced the motor components and supervised the assembly of the motors into the completed Trident missiles, all before the missiles were physically delivered to the United States Navy. Pet. 3. The sales of the rocket motors were part and parcel of an enterprise that did not end at Utah's borders.

3. This case is not similar to *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978), where the claim of double taxation was speculative. In *Moorman*, the taxpayer had not shown what portion of the sales in question had been taxed by the two jurisdictions. *Id.* at 276. Here, the record is clear that 100% of the income generated by the rocket motor sales was taxed in two separate states. While the Court in *Moorman* found that the Commerce Clause did not require perfect precision or prohibit "any overlap" in the apportionment of income tax among the states, *id.* at 278, the overlap in this case is more than *de minimis*, it is *total*. As such, this Court's holding in *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123 (1931), a decision not even addressed by respondent, provides the governing framework for this case. Utah's taxation of *100%* of the interstate commerce resulting in the rocket motor sales is "out of all appropriate proportion" and therefore violates the Commerce Clause. *Id.* at 135.

4. The decision by the Utah Supreme Court below and respondent's arguments in opposition to the petition are primarily an attempt to demonstrate that Utah appropriately considered the rocket motor transactions intrastate sales for purposes of determining income taxes. Even if these arguments were convincing, however, they still would not negate petitioner's second reason for urging this Court's review. Only this Court can resolve the controversy surrounding the taxation of the same income by more than one state. Because more than one state claims the right to tax the income generated by the rocket motor sales, this Court's guidance is necessary so that petitioner, and all other members of industry and com-

merce operating across state lines, can pay fairly apportioned taxes to the appropriate jurisdiction. Nothing in the record suggests that petitioner went "forum shopping" (Opp. 19) in an attempt to reduce its tax burden. Instead, petitioner paid income taxes to both of the states where its rocket motors were destined pursuant to the then-uniform interpretation of UDIPTA. Utah did not protest until five years later. The injustice addressed by the Commerce Clause is an individual state's attempt to burden interstate commerce unreasonably. Accordingly, the decision of the Utah Supreme Court disregarding the constitutional restraints of the Commerce Clause merits this Court's review.

CONCLUSION

For the foregoing reasons, and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

KEITH E. TAYLOR
MAXWELL A. MILLER
PARSONS BEHLE & LATIMER
201 South Main Street
Suite 1800
Salt Lake City, UT 84111
(801) 532-1234

REX E. LEE *
CARTER G. PHILLIPS
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